

The State Bar of California

Client Security Fund - 2006 Activities Report

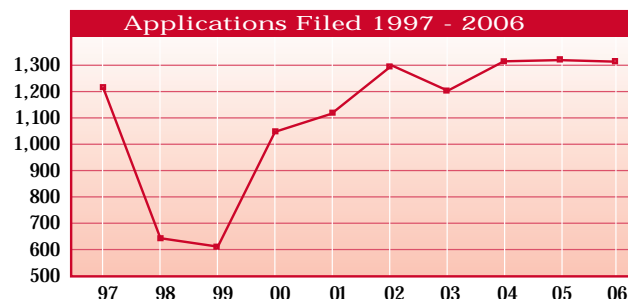
Public Protection Program

The Client Security Fund, established by bar-sponsored legislation in 1972, represents one of the State Bar's major efforts to achieve its public protection goals. In addition to disciplinary procedures, as part of the Bar's public service, the Fund helps to alleviate injury to legal consumers who sustain money or property loss as the result of dishonest conduct by a member of the Bar. The Fund is designed to reimburse victims who have lost money or property due to theft, or an act equivalent to theft, committed by a lawyer acting in a professional capacity.

The Fund provides the legal profession with a unique opportunity to promote public confidence in the administration of justice and the integrity of the legal profession. It is also a cost-effective way of providing reimbursement to victims that is generally not available from any other source. The Client Security Fund works closely and cooperatively with the State Bar's lawyer discipline system and the State Bar Court to achieve the Fund's objectives--to come to the aid of those clients who have suffered a loss caused by a diminutive number of errant lawyers.

Financed in 2006 by a \$40 annual assessment added to the membership dues paid by California active lawyers and a \$10 annual assessment paid by inactive lawyers, the Fund reimburses eligible applicants up to a \$50,000 maximum payment. However, there is no limitation on the aggregate amount paid against a Respondent attorney. Since its inception, the Fund has reimbursed applicants approximately \$81 million. In 2006, the Fund paid \$5,299,016 on 943 awards. The most typical losses reported are theft of client personal injury settlement funds and the refusal to refund fees when the lawyer performs no work.

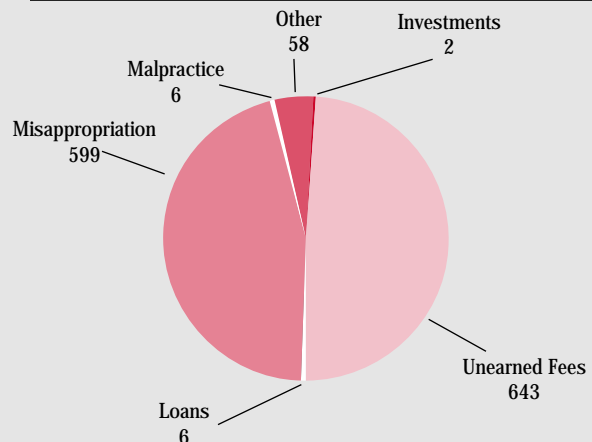
In 2006, the Fund received 1,314 new applications compared to 1,318 received last year. As the chart below reflects, the filing rate for new applications dropped significantly in 1998-99 due to the virtual shutdown of the discipline system during the fee bill crisis (i.e. June 1998 through March 1999). However, since the year 2000, the filing rates for new applications have continued to rise.



Number of Applications Filed by Category in 2006

Total: 1,314

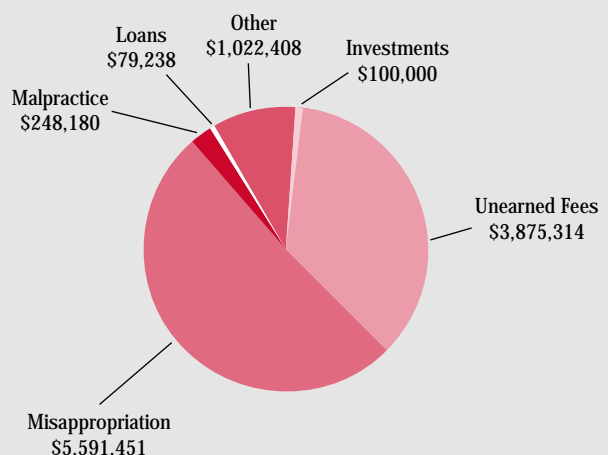
The largest number of applications filed was in the "unearned fees" category (48.9%). The second largest number of applications filed was in the "misappropriation" category (45.6%).



Dollar Amount of Applications Filed by Category in 2006

Total: \$10,916,591

While "unearned fees" cases comprised the largest number of applications filed, "misappropriation" cases comprised the largest dollar losses reported. Unearned fees cases represented approximately 35.5 percent of all dollar losses reported. Misappropriation cases represented approximately 51.2 percent of all losses reported.



"I would like to thank you and your department for the work that you do on behalf of individuals, who like myself have been victims of white collar crime."

(Quote from Applicant 2006)

Legislation

Oversight of the Client Security Fund is provided by the Legislature through a series of statutes, and by the Bar's Board of Governors through the Rules of Procedure, Client Security Fund Matters.

The State Bar's authority to operate the Client Security Fund is found in Business & Professions Code section 6140.5. This Legislation, effective March 4, 1972, was a result of a Board resolution dated June 17, 1971 and a Bar-sponsored bill. Section 6140.5(a) requires the Board to maintain a Client Security Fund.

Effective January 1, 2006, Section 6140.5(a) was amended to expand the purpose of the Client Security Fund to include relieving or mitigating pecuniary losses caused by the dishonest conduct of Foreign Legal Consultants registered with the State Bar and attorneys registered with the State Bar under the Multi-jurisdictional Practice Program.

Section 6140.5(b) provides a special statute of limitations whereby the Bar may bring an action to enforce its subrogation rights within three years of the date of payment to an applicant. Another part of the Bar's effort to collect against the errant lawyer is section 6140.5(c) which allows the Bar to add any CSF payout, plus interest and processing costs, to the membership dues bill of any lawyer who has been disciplined or resigns with discipline matters pending and seeks to be reinstated.

Section 6140.5(d) allows certain fund payments to be enforced as money judgments pursuant to Division 2 (commencing with Section 695.010) of the Code of Civil Procedure. This subdivision does not limit the power of the Supreme Court to alter the amount owed or to authorize the State Bar Court, in the enforcement of a judgment under this subdivision, to approve an agreement for the compromise of that judgment.

Section 6140.55 allows the Board to assess annually up to \$40 per active member and \$10 per inactive member to support the Fund. This assessment is to be used only for the purposes of the Fund.

Section 6149.5 serves as an early loss prevention measure. It requires insurers to provide written notice to a claimant of settlement payments of \$100 or more delivered to the claimant's lawyer or other representative in settlement of any third-party liability claim.

Another statute that affects the Fund is section 473 of the Code of Civil Procedure. Under this section, when a court sets aside a default judgment due to a party or attorney's mistake, inadvertence, surprise or excusable neglect, it may (1) impose a penalty of no more than \$1,000, (2) direct the offending attorney to pay up to \$1,000 to the Client Security Fund, or (3) grant such other relief as appropriate. Under this statute, the Fund received \$17,150 in 2006.

Rules and Coverage

The Fund is governed by the Rules of Procedure, Client Security Fund Matters which were adopted by the Board of Governors on December 21, 1985. Under these Rules, a seven-member Commission, appointed by the Board, acts as the Board's delegate in administering the Fund. From time to time, the Commission recommends to the Board amendments to the Rules of Procedure. Proposed rule changes are circulated for public comment before final action is taken by the Board.

The rules set forth the scope and purpose of the Fund, the authority of the Commission, the requirements for reimbursement, the application process, the confidentiality of the Fund records, and judicial review of Commission decisions. An applicant or Respondent lawyer may seek judicial review of a Final Decision of the Commission in the superior courts of the State under section 1094.5 of the Code of Civil Procedure.

General Basis for Reimbursement

An applicant must establish the loss of money or property which came into the hands of an active member of the State Bar while acting as a lawyer, trustee or fiduciary as defined in the Rules of Procedure, Client Security Fund Matters, and which loss was caused by a dishonest act as defined under the rules.

Rule of Limitations

Applications for reimbursement from the Fund must be filed within four years after the applicant discovers or reasonably should have discovered the loss.

Status of the Lawyer

In order for reimbursement to be paid, the lawyer whose dishonest conduct caused the loss must have been acting as a lawyer, or in a specified fiduciary capacity, such as the trustee of an express trust or as an escrow holder.

Also, the lawyer must have been disciplined, voluntarily resigned, died, been found mentally incompetent or been judged guilty of a crime that involved the loss. The Rules do give the Commission the discretion to waive this requirement under certain limited circumstances - for example, in clear cases when formal charges have been filed but the lawyer has not yet been disciplined.

Dishonest Conduct

A lawyer's dishonest conduct that can lead to payment from the Fund includes:

- theft or embezzlement of money or the wrongful taking or conversion of money or property;
- refusal to refund unearned fees received in advance where the lawyer performed no services or an insignificant part of the services contracted for such that the lawyer can be regarded as having lacked the intention to perform at the time payment was received;
- the borrowing of money from a client without the intention or the reasonably anticipated ability to repay it;
- obtaining money or property from a client by representing that it would be used for investment purposes when no investment is made; or
- an act of intentional dishonesty or deceit which directly leads to the loss of the money or property.

Losses not Covered

The Fund will not reimburse a loss if:

- it was covered by insurance, a bond or another fund;
- it was caused by negligence or malpractice; or
- it was a bad business loss such as a failed investment.

The Fund also does not cover "interest," "incidental or consequential losses" or "expenses" caused by the attorney. Examples of incidental or consequential losses would include fees applicant paid to another attorney or damages caused by malpractice, negligence or incompetence.

Applications Paid by Category

In 2006, the Fund paid out \$5,299,061 on 943 awards.

The largest number of applications paid was in the "misappropriation" category (50.58%). The second largest category by size was "unearned fees" (49.1%) with "loans" and "investments" representing only a few of the applications paid.

Number of Applications Paid by Category in 2006 Total: 943

Misappropriation	477
Unearned Fees	463
Loans	3
Investments	0

5-Year Summary of Applications Paid

2006	943
2005	982
2004	746
2003	701
2002	782

"It was a great assistance to me and I must thank your goodself for this kind help."

(Quote from Applicant 2006)

Dollars Paid by Category

In 2006, "misappropriation" cases represented the largest dollar amount of applications paid. \$3,650,986 or approximately 68.9 percent, of all dollars paid out were in the "misappropriation" category. "Unearned fees" cases represented approximately 28.96 percent of all dollars paid out with "loans" and "investments" representing a few percent of the total payouts.

Dollars Paid by Category in 2006 Total: \$5,299,061

Misappropriation	\$3,650,986
Unearned Fees	\$1,534,440
Investments	\$0
Loans	\$113,635

5-Year Summary of Applications Paid in Dollars

2006	\$5,299,061
2005	\$4,648,584
2004	\$5,681,455
2003	\$5,859,620
2002	\$6,597,057

"Thank you again for this wonderful news!!!"

(Quote from Applicant 2006)

Applications Closed

The 1,302 applications "closed" in 2006 include those that are paid, rejected and withdrawn.

5-Year Summary of Applications Closed

2006	1302
2005	1386
2004	1209
2003	1209
2002	1286

"I just received my reimbursement check and would like to thank you for your quick work and putting my life back on track. I thought my finances would never be the same, thanks again."

(Quote from Applicant 2006)

Applications Pending

The year 2006 closed with 797 applications pending, representing \$9,579,525 in reported losses.

5-Year Summary of Applications Pending at Year's End

2006	797
2005	787
2004	858
2003	759
2002	770

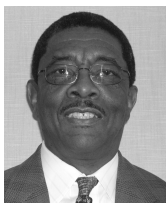
"With your assistance, a great hardship has been rectified and we have been made whole. Thank you so much for your diligence in this matter."

(Quote from Applicant 2006)

Commission Members



Richard F. Lyon, an attorney member, is currently a sole practitioner in El Cerrito, after 31 years in practice both in law firms and as an in-house corporate counsel. He was appointed in September 2003 and serves as Chair for 2006-2007. His term expires in September 2007.



Julius I. Davis, a public member, is a retired Los Angeles Police Department Assistant Chief. He was appointed in December 2004 and serves as Vice-Chair for 2006-2007. His term expires in September 2007.



Joyce L. Hurley, a public member, is a paralegal in a private legal firm in Los Angeles. She was appointed in September 2005. Her term expires in September 2008.



Daniel L. Nelson, an attorney member, is currently a managing partner in a personal injury litigation firm and is involved in a number of volunteer activities. He was appointed in September 2005. His term expires in September 2008.



Earl Paysinger, a public member, is currently Assistant Chief in the Los Angeles Police Department. He has served in a variety of command assignments and is currently the Director of Operations for the LAPD. He was appointed in October 2006. His term expires in September 2009.



Donna C. Riegel, an attorney member, is currently a sole practitioner in Pasadena with extensive and varied civil litigation experience. She has been a volunteer temporary judge with the Los Angeles County Superior Courts. She was appointed in October 24, 2004. Her term expires in September 2007.



David K. Willingham, an attorney member, is currently the Deputy Chief of the Major Frauds Section in the United States Attorneys Office for the Central District of California. He has been a prosecutor since 2001, handling primarily securities and investment fraud matters in the district. He was appointed in September 2005. His term expires in September 2008.

"Thanks for all your help. I really appreciated it."

(Quote from Applicant 2006)

"Thank you very much for returning the money."

(Quote from Applicant 2006)

"As the applicant for reimbursement in the subject matters, I thank you sincerely for your sympathetic response to my claims."

(Quote from Applicant 2006)

Decision Making

Policy oversight of the Client Security Fund is a joint responsibility of the Board of Governors and the Client Security Fund Commission.

The Board monitors the Fund through its: appointment of seven commissioners; approval of recommended changes and additions to the Rules of Procedure; consideration and approval of the Fund's annual administrative budget; and power to seek legislative authority to increase the lawyer's fees that support the Fund.

The Board exercises its authority as an entity and through its Regulation, Admissions, and Discipline Oversight Committee (RAD).

Of the seven volunteer members who comprise the Commission, no more than four of them may be lawyers. They are assisted by a professional staff of 9 who screen, analyze, investigate and present cases to the Commission. Staff is subject to Management oversight and in 2006 reported to Scott J. Drexel, the Chief Trial Counsel for the State Bar's discipline system.

Among the Commission's key functions are:

- determining applications made to the Fund after a written and oral presentation of the matter by CSF staff and, occasionally, after hearing held before the Commission;
- recommending to the Board of Governors necessary staffing levels to carry out the Fund's business in a professional, timely fashion;
- taking steps to increase the efficiency and timeliness with which the Commission and staff process applications;
- monitoring the Fund balance and recommending to the Board of Governors necessary fee increases to guarantee its continued solvency;
- interpreting the Rules of Procedure through policy statements and recommending necessary amendments and additions; and
- providing for the efficient inner workings of the Commission itself.



THE STATE BAR OF CALIFORNIA

Client Security Fund
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Los Angeles, CA 90015-2299
(213) 765-1140

www.calbar.ca.gov

Discipline Complaint Hotline: (800) 843-9053

CLAIMS ACTIVITY 2002 - 2006

Five-year Comparison

	# of Claims	2002 Amount	Claims	2003 Amount	Claims	2004 Amount	Claims	2005 Amount	Claims	2006 Amount
Claims outstanding, beginning of year	751	\$9,517,404	770	10,157,007	759	8,548,576	858	9,956,622	787	10,396,199
Prior year's outstanding claim adjustment increased/decreased	5	\$29,491	(2)	55,611	(13)	109,900	(3)	90,040	(2)	241,984
New claims	1,300	14,166,217	1,200	12,221,905	1,321	13,681,482	1,318	11,558,645	1,314	10,916,591
TOTAL CLAIMS	2,056	\$23,713,112	1,968	22,434,523	2,067	22,339,958	2,173	21,605,307	2,099	21,554,774
Less: Processed Claims:										
Paid	782	6,597,057	701	5,859,620	746	5,681,455	982	4,648,584	943	5,299,061
Rejected	39	2,580,784	39	2,585,959	39	1,701,671	50	2,535,698	24	1,799,629
Withdrawn	465	4,378,264	469	5,440,368	424	5,000,210	354	4,024,826	335	4,876,599
TOTAL PROCESSED CLAIMS	1,286	13,556,105	1,209	13,885,947	1,209	12,383,336	1,386	11,209,108	1,302	11,975,249
Claims outstanding, end of year	770	10,157,007	759	8,548,576	858	9,956,622	787	10,396,199	797	9,579,525
Claims outstanding increased/ decreased over beginning balance	19	639,603	(11)	(1,608,431)	99	1,408,046	(71)	439,577	10	(816,674)
Claims payout ratio		44.20%		45.26%		43.88%		43.79%		42.86%
Est. claims liability at payout ratio		\$4,489,397		\$3,869,086		4,368,966		4,552,496		4,105,784
NET ASSETS (end of year)		\$5,656,285		\$4,303,608		2,229,455		1,479,898		2,325,593
NET ASSETS (end of year, cash-basis)		\$10,145,682		8,172,695		6,598,421		6,032,393		6,431,377

Financial Picture

To have a complete picture of the Fund's fiscal health, it is important not only to see what money is on hand and how much has been actually paid out, but to also know how much is expected to be paid on pending cases. This anticipated payout, or accrued liability, is calculated by multiplying the total dollar amount of the pending cases times an estimated claims payable ratio. The claims payable ratio is based upon how much the Fund has historically paid for every dollar claimed. For example, if the Fund has historically paid \$.30 for every \$1 claimed, then the claims payable ratio is 30 percent.

The claims payable ratio used by the Fund is based upon a 24-month rolling average. The accrued liability changes, not only with changes in the claims payable ratio, but also as the total dollar amount of outstanding applications changes.

Balance Sheet

The balance sheet shows the Fund's assets and liabilities as of December 31, 2006.

Fund assets are maintained in cash and cash equivalents.

Current liabilities include estimated awards ultimately to be paid on applications which are pending as of December 31 plus next year's dues payments received early - for example, 2006 dues received in 2005.

The Fund balance or deficit is simply the difference between Fund assets and accrued liabilities.

Statement Of Revenues, Expenses And Changes In Fund Balance

Total revenues consist of members' dues, interest income and other revenues such as contributions.

Expenses include awards paid, accrued liabilities and administrative expenses. Awards constitute the major element. Off-set against this expense are any monies recovered from the bar's collection activities. This is reflected as "Awards Reimbursements or Recovery."

The Estimated Decrease/(Increase) in Awards Payable Liability is an adjustment made at the end of the year because of a change in the accrued liability.

"Thank you so much for this reimbursement check from my case!!! You will never know how much this means to me and my 9yr old daughter for my application for reimbursement being approved."

(Quote from Applicant 2006)

2004 - 2006 BALANCE SHEET STATEMENTS

	12/31/04	12/31/05	12/31/06
ASSETS:			
Cash	7,864,531	7,661,596	7,708,941
LIABILITIES & FUND BALANCES:			
Current liabilities	5,635,076	6,181,698	5,383,348
Net Assets	2,229,455	1,479,898	2,325,593
Total liabilities & Fund balances	7,864,531	7,661,596	7,708,491

2004 - 2006 STATEMENT OF REVENUES, EXPENSES AND CHANGES IN FUND BALANCES

	12/31/04	12/31/05	12/31/06
REVENUES:			
Membership dues	4,802,923	4,888,776	6,349,590
Investment Income	115,733	248,296	427,548
Other/Miscellaneous Revenues	-	-	5,103
TOTAL REVENUES	4,918,656	5,137,072	6,782,241
EXPENSES:			
Awards Paid/Accrued	6,150,467	4,770,392	4,836,217
Less: Awards Reimbursements or Recovery	(679,490)	(509,061)	(575,041)
CSF Claims Collection Exp.		16,592	9,287
Total	5,470,977	4,277,923	4,270,463
Administration	1,519,632	1,608,706	1,666,082
TOTAL EXPENSES	6,990,609	5,886,629	5,936,545
EXCESS (DEFICIT) OF REVENUES OVER EXPENSES	(2,071,953)	(749,557)	845,696
Estimated Decrease / (Increase) in Awards Payable Liability	499,879	(183,531)	446,712
Net Assets, as of year-end	2,229,455	1,479,898	2,325,593